

Testimony to Senate Taxation Committee—SB 70

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Mr. Chairman and Members of the Senate Taxation Committee, I recommend that you give approval to SB 70 that Sen. Wanzenried has introduced at the request of the Governor. This bill is included in the Governor's budget because it improves the fiscal stability of the State of Montana and helps match our commitments with our fiscal realities.

As addressed by the sponsor, Senator Wanzenried, and Budget Director Ewer, the central policy question raised by this bill is whether the State of Montana can afford to offer a lending service program to mostly large, out-of-state corporations when they experience losses—especially during economic recessions when the state treasury is already under stress. The question of affordability is heightened by the fact that net operating loss carryback refunds are financed by state funds that have been previously appropriated by the Montana legislature. Loss carryback refunds to large corporations makes the states finances both unpredictable and unstable.

In calendar year 2010, Montana refunded approximately \$7.8 million to 116 out-of-state corporations—or an average of about \$67,000 apiece. This \$7.8 million was essentially a loan made to these corporations to contribute to their cash flow needs—a loan made without any application process, at no interest and with no contract pledging repayment or even a commitment to create jobs in the state. While the cumulative total of \$7.8 million may be a significant amount to the Montana treasury, a one-time refund of \$67,000 to a major corporation is so small that it would unlikely to have any impact on corporate investment or job decisions. The corporation will claim the refund because it is worth the cost of filing an amended return claiming it, but we should be under no illusion that these amounts have any significance to decisions by a Fortune 500 corporation. Whether the State of Montana receives any benefit for this \$7.8 million in payments to out-of-state corporations is both unclear and questionable.

The rationale for eliminating the carryback refund program is reinforced by understanding the changes in business and economic conditions over the last several decades. Up until the mid-1990s, the regular corporate form of organization was more prevalent among small businesses and farms and ranches than today. However, since then the liberalization of S-corporation rules combined with the

creation of limited liability company laws have made these pass-through entity forms of organization much more common in the small business sector. These forms of business entities are taxed via their owners under the individual income tax laws. Hence, corporate net operating loss refunds are much less relevant to small businesses today than decades ago because proportionately fewer small businesses are organized as regular corporations. Thus, corporate net operating loss carryback refunds are increasingly concentrated with large, out-of-state corporations. Such corporations have access to a variety of private sector financial mechanisms, such as in the commercial paper market, to cover their cash flow needs far beyond state loss carryback refunds. The free market appears to be able to meet this corporate financing need without a state—especially small states like Montana—offering what are in fact no interest loans from their state treasuries at the very time that those treasuries are under stress from economic downturns.

Increasingly states have decided that corporate net operating loss carrybacks are not affordable and justifiable. Montana and Louisiana are the only two states left offering unlimited net operating loss carrybacks to regular corporations. Most offer none. Can Montana with its modest fiscal resources really afford to continue to offer cash flow financing to major corporations? We recommend that Montana cease providing this public line of credit to corporations capable of securing cash flow financing in private sector financial markets.